

**MEMORANDUM**

To: Members of the Investment Committee
California Public Employees' Retirement System

Date: August 15, 2011

From: Pension Consulting Alliance, Inc. (PCA)

RE: Revision of Real Assets – Real Estate Program Policy

In our capacity as Real Estate Consultant to the Board, Pension Consulting Alliance, Inc. (PCA) has reviewed the proposed modifications to the above referenced Real Asset Policy for the Real Estate Program.

Background

The new real estate strategic plan focuses investment on stabilized, cash producing and leased properties. PCA believes the proposed real estate policy is aligned with the objectives of the strategic plan adopted by the Investment Committee. Because the new strategic plan marks a significant change for the portfolio, the new real estate policy adopted by the Investment Committee in June 2011, has interim limits on Key Policy Parameters, including risk classification exposure, (Core, Value Add and Opportunistic), Loan-To-Value ratios, debt service coverage ratios and geographic exposure amongst others. The first sets of interim limits on Key Policy Parameters are much wider and will last for two years. On July 1, 2013, the Key Policy Parameter limits will automatically adjust to more stringent ones that are more closely aligned with the real estate strategic plan. Finally, on July 1, 2015, the actual strategic limits that were already presented to the Investment Committee will come into effect. In essence, the interim Key Policy Parameters give Staff a four-year window to shift the real estate portfolio towards one that is more cash-flow oriented. PCA believes this is an adequate amount of time, and allows for optimization of the current holdings in real estate which may not fit the new strategy.

Update

With the adoption of the new policy for Real Estate in June, Staff began reorganizing reporting to support the new policy. In doing so, it was recognized that portfolio's exposure to two specific Property Types – For Sale Land and Residential and Other Property Types (e.g., Senior Housing, Student Housing, Self Storage) – are already in breach of the new adopted limits of 10% for each segment. It is important to note that approximately 65% of the assets in these two property types are part of the Legacy portfolio. As such, in order for Staff to optimize the value of the legacy assets, as directed by the Investment Committee, additional time and flexibility to make incremental investment decisions will be necessary. Staff has indicated that the proposed increase of the limits to 15% from 10% will accommodate ongoing portfolio investment and deleveraging.

Additionally, quarterly reports will be provided by both the Board Consultant and Staff to keep

the Investment Committee apprised of the progress in transitioning the real estate portfolio.

Based on our review of the current proposed modifications and other supporting documentation, PCA concurs with the proposed modifications to the Statement of Investment Policy for Real Assets – Real Estate Program.

Respectfully,



Paul Mouchakkaa

Managing Director